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No. 79-511

In the Supreme Court of the United States

OCTOBER TERM, 1979

ANNE MOEN BULLITT BIDDLE BREWSTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. McCREE, JR.
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Petitioner seeks review of the decision below holding that a portion of her gross income from the operation of an Irish horse farm represented a reasonable allowance as compensation for her personal services and was therefore excludable from gross income under Section 911 of the Internal Revenue Code of 1954 (26 U.S.C.), and that a corresponding portion of the expenses incurred in producing that income was chargeable against the excluded amount and was therefore nondeductible.

The pertinent facts are undisputed and can be summarized as follows: Petitioner is a United States citizen and was engaged in the business of breeding, training, and racing horses in Ireland during her

residence there in the 1960's (Pet. App. 4a; JA 28).[1] Petitioner conducted these activities as an individual proprietor. It was stipulated that both her personal services and capital were material income-producing factors in this business (JA 28).[2]

Petitioner reported a net farm loss on each of her federal income tax returns for 1962-1965 and 1967-1969, which she claimed as an offset against her United States source income. On audit, the Commissioner of Internal Revenue determined that 30% of petitioner's gross farm income in each year represented "a reasonable allowance as compensation for * * * personal services" and was therefore excludable from gross income under Section 911 of the Internal Revenue Code of 1954, and that a corresponding portion of petitioner's farm expenses was "allocable to or chargeable against" the excluded amount and nondeductible under Section 911(a) (Pet. App. 24a-25a).

In this proceeding brought by petitioner in the Tax Court for redetermination of the resulting deficiencies, the Tax Court upheld the Commissioner. In accordance with its earlier decision involving the same taxpayer (*Brewster* v. *Commissioner*, 55 T.C. 251 (1970), aff'd, 473 F. 2d 160 (D.C. Cir. 1972) (*Brewster I*)), the Tax Court ruled that the provisions of Section 911 were fully applicable to foreign service-capital businesses operated at a loss, as was the case here (Pet. App. 26a-29a). The court also upheld the Commissioner's determinations with respect to

[1]"JA" refers to the separately bound joint appendix filed in the court of appeals.

[2]Although a horse farm as large as petitioner's would ordinarily have employed both a breeding manager and a racing trainer, petitioner performed both of those functions herself (JA 44-46).

the amounts that were a reasonable allowance as compensation under Section 911(a) and the nondeductible amounts of expenses properly allocable to the excluded income (Pet. App. 29a-41a).[3] The court of appeals affirmed (Pet. App. 1a-19a).

1. Section 911(a) of the Internal Revenue Code of 1954 permits a United States taxpayer who establishes foreign residence for a prescribed period of time to exclude from his gross income the amount of "earned income" attributable to services performed abroad. For these purposes, Section 911(b) defines the term "earned income" to mean "wages, salaries * * * and other amounts received as compensation for personal services actually rendered." Where, as here, the taxpayer is engaged in a business in which both personal services and capital are material income-producing factors, "a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income."

In *Brewster I*, petitioner reported a net farm loss for each of the years at issue. She therefore argued that she had not received any "earned income" from her horse farm activities so that none of her farm expenses would be subject to disallowance. In her view, the proper measure of "earned income" for service-capital businesses—defined under Section 911(b) as "a reasonable allowance as compensation for [the taxpayer's] personal services * * *, not in excess of 30 percent of [the taxpayer's] share of the net profits" of [illegible] business—was zero in the case of a service-capital business operated at a loss. Both the Tax Court and court of appeals concluded otherwise. They

[3]Petitioner does not now challenge that factual determination (see Pet. 2).

held that the proprietor of a service-capital business could render personal services of value to a business even though that business lost money (55 T.C. at 253-255; 473 F. 2d at 162-164). Here, the court of appeals adhered to its earlier decision on this question as a matter of *stare decisis*.

Petitioner contends (Pet. 6-11) that the court of appeals' adherence to its decision in *Brewster I* denied her an opportunity to be heard.[4] But the Tax Court and court of appeals fully considered her arguments as to why that decision should not be controlling on the legal issue presented here. The fact that petitioner resides abroad does not distinguish her from any other taxpayer who seeks to relitigate a question previously decided against him.[5] That petitioner did not stipulate in this case as to the amounts involved (as she had in *Brewster I*) may have enabled her to raise additional issues not resolved in the

[4]Contrary to petitioner's assertion (Pet. 7-11), the fact that Section 7482(b)(1) of the Code provides that United States citizens living abroad can appeal a Tax Court decision only to the United States Court of Appeals for the District of Columbia Circuit has no bearing on whether petitioner in this case received a fair consideration of her claims. Petitioner could have chosen to pay the tax determined against her and sought relief in the Court of Claims if the Commissioner denied her claim for refund. That there may be less opportunity for nonresident taxpayers to develop conflicts of decision on legal issues peculiar to citizens residing abroad furnishes no basis for relieving them of the ordinary consequences of the doctrine of *stare decisis*.

[5]This case differed from *Brewster I* only with respect to the measure of income and expenses subject to adjustment under Section 911. In *Brewster I*, petitioner stipulated to the amounts to be excluded from gross income and the expenses to be disallowed in the event the courts concluded that Section 911 applied to a service-capital business operated at a loss. Here, however, petitioner unsuccessfully contested the Commissioner's determinations with respect to the amounts of income and expenses subject to Section 911.

earlier proceeding. But the court below did not condition its holding in *Brewster I* "on the reasonableness of the Commissioner's determinations on excludable earned income from year to year and from taxpayer to taxpayer" (Pet. App. 10a). To the contrary, it adhered to its decision in *Brewster I* because petitioner "offer[ed] no cogent basis favoring departure from" the holding of the earlier case (Pet. App. 9a).

2. At all events, *Brewster I* was correctly decided. As the court of appeals pointed out (Pet. App. 8a), the exemption provided for under Section 911 is framed in terms of gross income rather than net profits. Accord, *Cook* v. *United States*, 599 F. 2d 400, 403 (Ct. Cl. 1979). If the term "earned income" referred only to net profits, as petitioner argues (Pet. 11-14), there would have been little reason for Congress to have provided for the disallowance of expenses allocable to or chargeable against excludable earned income, since a "net" concept would have automatically taken such expenses into consideration. The court of appeals therefore correctly observed (Pet. App. 8a-9a) that a taxpayer can "earn income from personal services despite the fact that the income derived from a business that lost money." See *Hempel* v. *Commissioner*, P-H Memo T.C., par. 47,183 (1947); *Painter* v. *Commissioner*, P-H Memo T.C., par. 76,164 (1976). While *Hempel* and *Painter* involved "services only" businesses, there is no basis, under either the terms of the statute or its underlying policy, for reaching a different result in the case of a service-capital business.

3. Contrary to petitioner's further argument (Pet. 14-18), the decision below does not conflict with *Vogt* v. *United States*, 537 F. 2d 405 (Ct. Cl. 1976). The issue there was whether, for purposes of calculating the amount

of the Section 911 exclusion, the maximum dollar amount was to be applied against a partner's share of his partnership's net income, or against his share of partnership gross income with a corresponding disallowance of partnership expenses. In concluding that this limitation should apply to the taxpayer's share of partnership net income, the court carefully pointed out that it was dealing with the question strictly as a partnership question. Indeed, it specifically noted that *Brewster I* was "distinguishable from the set [of facts] now before us" (537 F. 2d at 415), and that the holding of that case was "necessary to prevent the deduction of foreign expenses from U.S.-source income," a result that "would have violated the original purpose of the disallowance-of-deductions provision" (537 F. 2d at 415 & n. 23). Moreover, any remaining question as to whether the Court of Claims would follow *Brewster I* was resolved by that court's decision in *Cook* v. *United States*, *supra*, 599 F. 2d at 403-404, in which it squarely rejected the contention that *Vogt* required a different result.[6]

4. Finally, contrary to petitioner's speculations (Pet. 18-19), there are, apart from her own cases, no more than three pending cases involving the question whether Section 911 applies to service-capital businesses operated at a loss. Moreover, the scope of Section 911 was substantially narrowed by Section 202 of the Foreign Earned Income Act of 1978 (Pub. L. No. 95-615, 92 Stat. 3097, 3098) in a manner that effectively resolves the issue in this case. For years beginning after December 31, 1977,

[6]Petitioner errs in arguing (Pet. 9 note 10, 12 note 13) that prior to *Brewster I*, the Commissioner took the position that Section 911 did not apply to service-capital businesses operating at a loss. As the court stated in *Cook*, "[t]he contrary is clearly true" (599 F. 2d at 404).

the foreign earned income exclusion and disallowance provisions apply only in the case of a taxpayer living abroad who, "because of his employment, resides in a camp located in a hardship area." In addition, Section 911(d) of the Code, also added by Section 202 of the Foreign Earned Income Act of 1978, now provides that a taxpayer may elect, for taxable years beginning after December 31, 1977, not to have the provisions of Section 911 apply for the taxable year. As a result, cases where Section 911 may operate to a taxpayer's disadvantage will no longer arise for future years.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

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